

DIRECT TESTIMONY

OF

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ACCOUNTING DEPARTMENT

FINANCIAL ANALYSIS DIVISION

ILLINOIS COMMERCE COMMISSION

AMERITECH ILLINOIS  
INVESTIGATION INTO ALTERNATIVE REGULATION PLAN

DOCKET NOS. 98-0252/0335 (CONSOL.)

NOVEMBER 3, 2000

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**WITNESS IDENTIFICATION**

1    **Q.     Please state your name and business address.**

2    A.     My name is Mary H. Everson. My business address is 527 East Capitol Avenue,  
3           Springfield, Illinois 62701.

4    **Q.     By whom are you employed and in what capacity?**

5    A.     I am an Accountant in the Accounting Department of the Financial Analysis Division  
6           of the Illinois Commerce Commission.

7    **Q.     Please describe your background.**

8    A.     I have a Bachelor of Science in Accounting from the University of Central Florida. I  
9           am a Certified Public Accountant licensed to practice in the State of Illinois. I joined  
10          the Staff of the Illinois Commerce Commission in February 1999. Prior to joining  
11          Staff, I was employed in industry as a financial analyst and in government as an  
12          internal auditor.

13   **Q.     What is the function of the Accounting Department of the Illinois Commerce**  
14          **Commission?**

15   A.     The Department's function is to monitor the financial condition of public utilities as  
16          part of the Commission's responsibilities under Article IV of the Public Utilities Act  
17          and to provide accounting expertise on matters before the Commission.

18 **Q. What are your responsibilities in this case?**

19 A. The Director of the Accounting Department of the Commission has assigned me to  
20 this case and defined the scope of my responsibilities. In this case I am to review  
21 Ameritech Illinois' ("Company" or "AI") filing, analyze the underlying data, and  
22 propose adjustments when appropriate.

23 **PURPOSE OF TESTIMONY**

24 **Q. What is the purpose of this testimony?**

25 A. The purpose of my testimony is to present adjustments to AI's directory revenue,  
26 incentive compensation plan, social and service club dues, advertising expense and  
27 external relations. These adjustments would be used to determine a revenue  
28 requirement if the Commission should decide to return to rate of return regulation of  
29 Ameritech. These adjustments are used in the computation of the revenue  
30 requirement in Staff Exhibit 5.0. My adjustments to AI's operating income are  
31 included in Staff Exhibit 5.0, Schedule 5.02. My adjustments to rate base are  
32 included in Staff Exhibit 5.0, Schedule 5.04.

33 **Q. Are you sponsoring any schedules as part of Staff Exhibit 7.0 ?**

34 A. Yes. I prepared the following schedules for the Company, which show data as of, or  
35 for the test year ending December 31, 1999:

36

37        Adjustment Schedules

38            Schedule 7.01            Directory Revenue

39            Schedule 7.02            Incentive Compensation Plan

40            Schedule 7.03            Social and Service Club Dues

41            Schedule 7.04            Advertising Expense

42            Schedule 7.05            External Relations

43        **DIRECTORY REVENUE**

44        **Q.        Please explain Staff Exhibit 7.0, Schedule 7.01, Directory Revenue.**

45        A.        Schedule 7.01, Directory Revenue, presents my adjustment to the Company's  
46            revenues for the imputed revenue ordered to be included in the Company's prior  
47            case, Illinois Bell Telephone Company, ICC Docket Nos. 92-0448/93-0239,  
48            (Consol.), dated October 11, 1994. In 92-0448/93-0239, the Commission found  
49            that Ameritech had rendered Illinois Bell's negotiating position worthless by  
50            guaranteeing that the 1984 Directory Services contract with Donnelly, then up for  
51            renewal or re-negotiation, would be renewed without a change in terms. On pages  
52            101 and 103 of the 92-0448/93-0239 Order, the Commission states:

53                    The Commission finds that during the 1990 negotiations which  
54                    involved IBT's exclusive option to renew the directories agreement,  
55                    IBT, Ameritech, and API failed to engage in arms length  
56                    negotiations. Instead, Ameritech and API used IBT's option as  
57                    bargaining leverage in negotiating an agreement that benefited only

API – Ameritech’s unregulated subsidiary. This was done to the detriment of IBT – Ameritech’s regulated subsidiary. By diverting the contract revenues from IBT to API, Ameritech shareholders received a windfall by not having the revenues count towards IBT’s revenue requirements.

Furthermore, the Commission concludes that staff’s \$51 million upward adjustment to revenues received by IBT from its directory relationship is necessary to prevent any harm to IBT’s ratepayers from Ameritech’s cross-subsidization of revenues from IBT to API.

In the Order, the Commission found in favor of Staff’s adjustment to directory revenue of \$51,000,000 and ordered that it be included in the Company’s revenue requirement. In the current proceeding, Staff believes that an adjustment is necessary to restore the revenues determined to be appropriate for ratemaking purposes as determined in Docket Nos. 92-0448/93-0239, (Consol.). Absent the necessary financial data to impute current directory revenue, Staff will use the total amount determined to be appropriate in the last docket, \$126,000,000 (\$75M directory contract + \$51M imputed directory revenue).

#### **INCENTIVE COMPENSATION**

**Q. Please explain Staff Exhibit 7.0, Schedule 7.02, Incentive Compensation Plan.**

**A.** Schedule 7.02 presents my adjustment to reduce operating expense and rate base related to the management incentive compensation plan.

**Q. Please explain your reason for disallowing the amounts associated with incentive compensation.**

A. The Company's plan is based on financial performance goals of return on assets and revenue growth. Inherent in these type of goals is a circular reasoning which clearly benefits the shareholders, but not the ratepayers. The circular reasoning is that the larger the increase in base rates granted, the greater the chances that Ameritech Illinois will meet the financial goals. Since the performance goals are based on the financial success of the Company, the larger the incentive compensation awards. This circle is never ending. This process, while providing benefits to the shareholders, provides little benefit to ratepayers, since the cost of the plan is included in the rate base and the revenue requirement regardless of whether the performance goals are met or not.

**Q. Has the Commission accepted similar adjustments for incentive compensation in prior orders?**

A. Yes. In Illinois Power Company Docket No. 93-0183, the Commission concluded that since financial goals benefit shareholders, ratepayers should not have to bear the cost:

Two of the goals, earnings per share and reduced O & M expenses are goals that benefit shareholders. If the shareholders are the ones to benefit, they should be the ones who foot the bill.<sup>1</sup>

In another docket, MidAmerican Energy Company Docket No. 99-0534, the Commission reached a similar conclusion regarding ratepayer benefit from incentive compensation based on financial goals:

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<sup>1</sup> Order, Illinois Power Company Docket No. 93-0138, dated April 6, 1994, p. 52.

103           The Commission is not convinced that the ratepayers are  
104           protected in the event that the targeted return on capital investment  
105           is not achieved. Ratepayers would still fund the projected levels of  
106           incentive compensation even if that level is not achieved.<sup>2</sup>

107           For the reasons outlined in the previous paragraphs, I am reducing the amount of  
108           rate base and operating expense related to incentive compensation payments  
109           because these payments produce no benefit to ratepayers.

110    **SOCIAL AND SERVICE CLUB DUES**

111    **Q.     Please describe Staff Exhibit 7.0, Schedule 7.03, Social and Service Club**  
112           **Dues.**

113    A.     Schedule 7.03 presents my adjustment to remove social and service organization  
114           dues from the Company's expenses. Participation in these groups is a promotional  
115           and goodwill practice that is not necessary to provide utility service. The  
116           Commission, in its Order in Commonwealth Edison Company, Docket No. 90-  
117           0169, recognized the importance of utility companies participating in these types of  
118           organizations, yet held that the shareholders, rather than the ratepayers, should bear  
119           the cost of participating in these organizations. The Commission, in its Orders in  
120           Commonwealth Edison, Docket No. 94-0065, dated January 9, 1995 and in Central  
121           Illinois Public Service Company, Docket No. 99-0121, dated August 25, 1999,  
122           affirmed this position in ruling to remove the cost of these types of membership

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<sup>2</sup> Order, MidAmerican Energy Company Docket No. 99-0534, dated July 11, 2000, p. 9.



123 dues. Therefore, I am adjusting the Company's operating expense to reflect the  
124 removal of these dues.

125 **ADVERTISING EXPENSE**

126 **Q. Please explain Staff Exhibit 7.0 Schedule 7.04, Advertising Expense.**

127 A. Schedule 7.04 presents Staff's adjustment to reduce test year operating expense by  
128 the amount of advertising expense because the Company did not provide evidence  
129 that the advertising was not promotional. Staff requested supporting documentation  
130 for advertising expense in SDR-040, DLH-011, MHE-006, MHE-007, MHE-024 and  
131 MHE-025. In its response to data requests MHE-006 and 007, the Company  
132 indicated that information related specifically to each advertising campaign or  
133 series of advertisements is not identified, tracked or reported for either internal or  
134 external purposes. The Company further indicated that the expenses related to  
135 advertising are included in accounts 6611, 6612, and 6613. However, in response  
136 to later data requests, MHE-024 and MHE-025, which requested information  
137 specific to yellow pages advertising, the Company was able to provide information  
138 related to that one type of advertising. Given this inconsistency in the Company's  
139 responses, Staff is unable to rely on any of the responses to data requests for  
140 advertising information. Therefore, Staff determined that another approach to the  
141 advertising issue was necessary.

According to the Uniform System of Accounts ("USOA"), account 6612 is to be used for costs incurred in selling products and services, and account 6613 is to be used for costs incurred for product advertising.

The Public Utilities Act defines promotional advertising that is prohibited for utility companies: Section 9-225(1)(c) and in 83 Ill. Adm. Code 295.10(a) prohibits inclusion of operating expenses related to promotional advertising in determining a public utility's revenue requirement. Promotional advertising is defined in that section as follows:

Unless the Commission otherwise orders, no electric or gas utility shall include as an operating expense in the test year computation any direct or indirect expenditures for promotional, political, institutional or good will advertising. In determining whether to allow a variation from this provision, the Commission shall consider, among other things, whether the advertising at issue is necessary to protect consumers, to promote more efficient use of the public utility's system, or to allow the public utility to compete effectively against non-regulated competitors.

The Company did not furnish the information requested to prove that amounts included in Ameritech Exhibit 7.0 Schedules 1 and 2 are expenditures for non-promotional advertising allowable advertising expense.<sup>3</sup> From the extremely limited information provided by the Company, Staff is unable to determine the exact nature and purpose for the company's advertising expenditures. Therefore, Staff relied on the USOA as a guide to the types of expenses to be charged to each account, and determined that the total amounts in accounts 6612 and 6613 should be removed to prevent inclusion of non-allowable product and promotional advertising. Should the

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<sup>3</sup> Allowable in rates recovered from ratepayers according to Section 9-225 of the Public Utilities Act, 83 Ill. Adm. in. Code Sections 275 and 295.

Company be able to provide detailed information on each advertising campaign expense for review, Staff is willing to consider that information. However, without the necessary detail regarding advertising expense, the total amount must be removed to prevent the ratepayers from having to pay for the Company's product promotion and sales expenses.

**EXTERNAL RELATIONS**

**Q. Please explain Staff Exhibit 7.0 Schedule 7.05, External Relations.**

A. Schedule 7.05 presents my adjustment to reduce test year operating expense by the amount of external relations expense because amounts charged to this account are related to corporate image advertising, review of pending legislation, public relations and investor relations activities. These types of activities do not produce benefits to the captive ratepayers, but instead, boost the corporate image, which benefits only the shareholders. As stated above in the Advertising Expense section of this testimony, the Public Utilities Act Section 9-225(1) outlines promotional advertising that is prohibited for utility companies, and 83 Ill. Adm. Code 295.10(a) prohibits inclusion of operating expenses related to promotional advertising in determining a public utility's revenue requirement. The Public Utilities Act defines goodwill or institutional advertising as follows in section 9-225(d):

"Goodwill or institutional advertising" means any advertising either on a local or national basis designed primarily to bring the utility's name before the general public in such a way as to improve the image of the utility or to promote controversial issues for the utility or the industry.

190 Ameritech's external relations activities that are charged to account 6722 fall within  
191 this definition. Therefore, due to the goodwill and promotional nature of these  
192 expenses, amounts in account 6722 should be removed from test year operating  
193 expense. For these reasons I am proposing to adjust external relations expense.

194 **CONCLUSION**

195 **Q. Does this conclude your prepared direct testimony?**

196 **A.** Yes, it does.